No. 22342

In the

United States Court of Appeals

For the Ninth Circuit

FARMERS INSURANCE EXCHANGE,
Appellant,

vs.

JOE ROSE, JR. and VERONICA ROSE, his wife,
Appellees.

Appeal from the United States District Court
for the District of Arizona

Brief for Appellant Farmers Insurance Exchange

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SUBJECT INDEX

TABLE OF AUTHORITIES CITED

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STATEMENT OF PLEADINGS AND FACTS DISCLOSING JURISDICTION

Appellant Farmers Insurance Exchange is an insurance exchange which is organized under the laws of the State of California, has its principal place of business in California and is a citizen of the State of California. Appellees Joe Rose, Jr. and Veronica Rose, his wife, are residents and citizens of the State of Arizona.

The amount in controversy, exclusive of interest and costs, exceeds the sum of Ten Thousand Dollars ($10,000.00).

The District Court had jurisdiction under the provisions of 28 U.S.C.A. § 1332. The judgment of the District Court was rendered by the United States District Court for the District of Arizona on July 28, 1967. Appellant has appealed from said judgment. This Court has jurisdiction upon this appeal to review the said judgment under the provisions of 28 U.S.C.A. § 1291.

STATEMENT OF THE CASE

(References made below, unless otherwise indicated, are to page numbers in the Transcript of Record.)

This is an action for declaratory judgment. The complaint describes the basic facts giving rise to the suit. (1) On or about January 10, 1964, appellant issued an automobile liability insurance policy to David Vassar. The policy provided for coverage in the amount of $50,000.00 for injuries suffered by one person, and $100,000.00 for injury sustained as a result of one accident. In his written application for said policy and in his oral communications to the representative of appellant at the time of his application for said policy, Mr. Vassar made certain statements and representations which were fraudulent and material to the acceptance of the risk and the hazard to be assumed by appellant. The appellant would not have issued the policy to Mr. Vassar if Mr. Vassar had not made such fraudulent misrepresentations. (Affidavit of Mr. White, Exhibit D to appellant's motion for summary judgment [50].) The primary, but not the sole, misrepresentation which Mr. Vassar made related to his driving record. Item 28 of the application form asked for details of all accidents and citations during the preceding three years, i.e., the three years prior to January 10, 1964. Vassar told the insurance agent that he had had only two accidents or citations during the pre-

ceding three-year period. (Deposition of Mr. Garfield, pp. 54-56.) The written application form actually signed by Vassar conveyed the same information. However, the application form actually signed by Mr. Vassar was lost. In any event, rather than the two citations in the preceding three years which Mr. Vassar revealed, or which were referred to in his written application, Mr. Vassar had in fact had seven citations in the preceding three years, five of which had been received in the preceding 13 months, of which four had been received within the preceding 5 months and 5 days. (See attachment to appellant's motion in limine [224].) Approximately two months and two weeks after Mr. Vassar was issued a policy and while driving the insured automobile, Mr. Vassar was involved in an automobile accident as a result of which appellees were injured.

In May, 1964, two months after this accident, appellant filed this lawsuit, asking the court to determine that, under the circumstances stated, the policy issued Vassar was void and no coverage was extended to him thereunder. Named as defendants in the action were appellees and Mr. Vassar, who was a party to the action before the District Court, but who is not an appellee hereunder.

After discovery procedures were utilized by appellant and appellees, both parties to this appeal at different times filed motions for summary judgment. There were separate briefs and arguments on each such motion and each was denied on the ground that there were disputed areas of fact. (124, 196.)

The Financial Responsibility Laws of the State of Arizona provide that the amount of automobile liability insurance required under said laws shall be $10,000.00 for injury to any person, and $20,000.00 for injuries arising out of a single accident.

On July 3, 1967, appellees filed their second motion for summary judgment. (269.) The issues were briefed and the motion was argued before the court on July 24, 1967, the day before the case was to be tried. Appellees' sole argument on this motion for summary judgment was that under the decision of the Arizona Supreme Court in *Sandoval v. Chenoweth,* ..... Ariz. ....., 428 P.2d 98 (1967), appellees were entitled to prevail on the declaratory judgment action as a matter of law. The District Court ruled in favor of the appellees on the day of the hearing on the motion and the case was not tried. Judgment was entered in favor of appellees. The judgment decreed that the liability of appellant on its policy became absolute as to appellees to the full extent of the policy limits of coverage upon the occurrence of appellees' injuries on March 24, 1964. (318.)

As a result of the foregoing, the following issues arise:

1. Under the laws of the State of Arizona, when an accident occurs, is an insurance company automatically precluded from asserting any policy defense, specifically including the defense of fraud in the procurement of the policy?

2. If the answer to the question just posed is in the affirmative, is the insurer precluded from asserting such a defense only to the extent of the required amount of coverage under the Financial Responsibility Laws of the State of Arizona, or is it precluded from asserting such defense at all, so that no policy defense is available to the full extent of the face amount of the policy?

SPECIFICATIONS OF ERROR

1. The District Court erred in Paragraph 1 of the judgment entered on July 28, 1967, by holding that the liability of Farmers Insurance Exchange under its policy of liability insurance issued to David R. Vassar became absolute as

to Joe Rose, Jr. and Veronica Rose, his wife, appellees, upon the occurrence of the injury to Mr. and Mrs. Rose on March 24, 1964.

2. The District Court erred in Paragraph 1 of the judgment entered on July 28, 1967, by holding that the liability of Farmers Insurance Exchange, appellant, under its policy of liability insurance became absolute in favor of Joe Rose, Jr. and Veronica Rose, his wife, to the full extent of the policy limits of coverage upon the occurrence of the injury to Mr. and Mrs. Rose on March 24, 1964.

3. The District Court erred in Paragraph 2 of the judgment entered on July 28, 1967, by awarding appellees their costs, because such award was inappropriate in view of the errors referred to in Paragraphs 1 and 2 above.

SUMMARY OF ARGUMENT

1. The District Court erred in Paragraph 1 of the judgment entered on July 28, 1967, by holding that the liability of appellant under its policy of liability insurance issued to David R. Vassar became absolute as to appellees upon the occurrence of the injury to appellees on March 24, 1964.

2. The District Court erred in Paragraph 1 of the judgment entered on July 28, 1967, by holding that the liability of appellant under its policy of liability insurance became absolute in favor of appellees to the full extent of the policy limits of coverage upon the occurrence of the injury to appellees on March 24, 1964.

ARGUMENT

Preamble

The judgment of the District Court was that under the decision of *Sandoval v. Chenoweth,* supra, the liability of an insurer becomes absolute upon the occurrence of any accident, that no policy defense, even for fraud in the procure-

ment of the policy, is available to the insurer as against an innocent third party once an accident has occurred, and that these principles are applicable to the full extent of the policy limits. The District Judge stated orally at the time of the hearing on appellees' motion that he was ruling as he ruled because of *Sandoval v. Chenoweth,* supra. Thus, the question at issue is whether under Arizona law, including *Sandoval v. Chenoweth,* supra, the judgment of the District Court was correct. This is not a case where the local judge has a peculiar feeling or awareness of the local law. This is the case where a judge was faced with the same state of the law faced by this Court when it decided *Weekes v. Atlantic,* 370 F.2d 264, on December 20, 1966, except for the *Sandoval* case.

The Arizona Supreme Court has not ruled on the issue which was before the District Court or which is presently before this Court. The decision of the District Court is not required or appropriate by virtue of the *Sandoval* case as the District Court believed. The decision of the District Court is directly contrary to the decision of this Court in *Weekes v. Atlantic,* supra, where this Court ruled that under an insurance policy with the exact language as is set forth in the policy involved in this case, the policy defense is available for any coverage in excess of the amount of liability coverage required by the Financial Responsibility Act. (See affidavit attached as Exhibit A to appellant's supplemental memorandum in response to motion for summary judgment [286] and policy attached thereto.)

The Jenkins and Sandoval Decisions

The District Court's ruling was based solely and expressly on *Sandoval v. Chenoweth,* supra. *Sandoval* is an outgrowth of *Jenkins v. Mayflower,* 93 Ariz. 287, 380 P.2d 145 (1963).

In *Jenkins* an insurer contended that there was no coverage due to a provision in the policy that by its terms made the policy inapplicable when a serviceman was driving the insured automobile. The Court denied the claim of exclusion from coverage on the ground that the omnibus clause required in a liability policy issued to comply with the Financial Responsibility Act was part of the motor vehicle policy by operation of law.

In *Sandoval* the Arizona Supreme Court held that an insured's failure to give his insurer notice of the filing of a lawsuit, which failure was a breach of a policy provision, does not defeat the right of a third party plaintiff to recover against the insurer. The decision in *Sandoval* was really on two points. The court reaffirmed its decision in *Jenkins*. It ruled that under the provisions of A. R. S. § 28-1170-F-1, no violation of the policy shall defeat or avoid it and that such provisions were controlling. The balance of the decision dealt somewhat succinctly with the question as to whether a policy defense was precluded to the extent of insurance coverage required by the Financial Responsibility Act or to the extent of full face amount of the policy.

In *Sandoval* the Arizona Supreme Court refers in depth to *Wildman v. Government Employees' Ins. Co.,* 48 Cal.2d 31, 307 P.2d 359, and to *Globe Indemnity Co. v. Universal Underwriters Insurance Co.,* 20 Cal.Rptr. 73, 201 Cal.App.2d 9. Neither of these cases involved statutory provisions such as we are concerned with here (i.e., provisions such as the provisions of the Arizona Financial Responsibility Act, including A. R. S. § 28-1170-B-F-G).

In *Wildman,* the Court was faced with a restrictive provision restricting coverage for a permissive driver. The Court held:

> "We are of the opinion that for an insurer to issue a policy of insurance which does not cover an accident

> which occurs when a person, other than the insured, is driving with the permission and consent of the insured is a violation of the public policy of this state as set forth in sections 402 and 415 of the vehicle code."

Section 402 of the Vehicle Code, now section 17150 of the Vehicle Code, simply provides that every owner of an automobile is liable to an injured person for injuries sustained as a result of the negligence of any permissive user.

Section 415 of the Vehicle Code, now section 16451 of the Vehicle Code, is a part of the financial responsibility law and requires that policies referred to under said laws cover permissive drivers. The court held, therefore, that the permissive driver provisions of sections 402 and 415 of the Vehicle Code were a part of the policy and therefore a permissive driver would be an insured under the terms of the policy and consequently covered to the full extent of the policy limits.

Likewise, in *Globe* the court was concerned with a permissive user exclusion. The court said:

> "Since appellants fail to sustain their first major position that the policy did not cover the permissive user we turn to the second basic argument that the trial court erred in affording Moore coverage to the full limits of the policy. We believe that Moore assumes the status of an insured under the policy and hence receives its whole protection. Moore thus becomes an additional insured under the policy and obtains its protection as much as the 'partner, employee, director or stockholder' who is specifically named in the policy's 'Definitions of Insured.' *Since the limitations of paragraph 8 do not affect the situation, and since the policy itself contains no differentiations as to those insured or the amounts of the protection, we find no basis for curtailment of Moore's coverage.*" (Emphasis added.)

The court went on to say:

"The policy contained this provision:

' "Financial Responsibility Laws. Such insurance as is afforded by this policy shall comply with the provisions of the motor vehicle financial responsibility law of any state or province which shall be applicable *with respect to any such liability* arising out of the existence, ownership, maintenance or use of any automobile during the policy period, to the extent of the coverage and limits of liability [as] required by such law." (Italics added.)' (P. 433, 296 P.2d p. 807.) The court held that compliance with Vehicle Code section 415 did not work a reduction of the limits of the policy to the minimum which the section permitted. The court said 'Here we have the seemingly explicit provision of section 415 of the Vehicle Code that "A 'motor vehicle liability policy,' as used in this code means a policy * * *, which policy shall meet the following requirements: * * * (2) Such policy shall insure the person named therein and any other person using or responsible for the use of said motor vehicle * * * with the * * * permission of said assured," and coupled with that are the provisions of the Highway Carriers Act * * * declaring that the coverage provided "shall comply with the provisions of the motor vehicle financial responsibility law * * * which shall be applicable with respect to *any such liability* arising out of the existence * * * or use of any automobile * * * to the extent of the coverage and limits of liability required by such law." (Italics added.) That language cannot properly be construed to mean minimum coverage or minimum limits; rather, it must be interpreted as providing full or maximum coverage in both aspects insofar as encompassed by the law and not exceeding the clear limitations of the contract.' (P. 438, 296 P.2d p. 810.)

"As respondent points out, since the Universal policy did not set up different provisions for omnibus insureds, the fact that Mason, 'unlike Moore, became an

> omnibus insured through an interpretation of a policy definition' does not differentiate the cases. The point is that once Moore became an insured by operation of law, and once Mason became an assured by application of the policy, they both were protected to the full limits of the policy. We must reject, therefore, appellants' attempt to meet the impact of the decisional language by an assertion that it 'was ill considered and should not be followed.' Again, we find the Supreme Court language binding upon us and conclusive in its reasoning."

It is vital to note that it is clear from *Globe* that the full limits of coverage were deemed to be applicable because of the mandatory California statutes on permissive users. The court was not considering a situation where the question was the extent to which a policy defense such as fraud was barred. Further, there is no provision like A. R. S. § 28-1170F1 in the California Financial Responsibility Act and therefore there is no way of knowing which way the California courts would go if faced with the problems now before this Court. We wish to point forcefully to the fact that in *Globe* the Court clearly stated that, since the policy contained no differentiation as to those insured or the amounts of the protection, it could find no basis for curtailment of coverage. Implicit in this statement, of course, is the fact that if there were such provisions in the policy they would have been honored as they were honored by this Court in *Weekes v. Atlantic,* supra, and as they should be honored in this case.

Differences Between Jenkins and Sandoval and This Case

There are decisive differences between the laws applicable in *Jenkins* and *Sandoval* and the law applicable here, and the facts in *Jenkins* and *Sandoval* and the facts here.

The effect of the District Court's decision is contrary to and invalidates an express statute. No such step was taken or required by the Arizona Supreme Court in *Jenkins* or *Sandoval.*

A. R. S. § 20-1109 provides as follows:

> "All statements and descriptions in any application for an insurance policy or in negotiations therefor, by or in behalf of the insured, shall be deemed to be representations and not warranties. Misrepresentations, omissions, concealment of facts and incorrect statements shall not prevent a recovery under the policy unless:
>
> 1. Fraudulent.
> 2. Material either to the acceptance of the risk, or to the hazard assumed by the insurer.
> 3. The insurer in good faith would either not have issued the policy, or would not have issued a policy in as large an amount, or would not have provided coverage with respect to the hazard resulting in the loss, if the true facts had been made known to the insurer as required either by the application for the policy or otherwise."

It should be kept in mind that to deprive the appellant in this case of a policy defense is to completely nullify and render void A. R. S. § 20-1109 in its application to automobile liability policies. The Arizona Supreme Court was not faced with such a statute in *Jenkins* or *Sandoval.* As a matter of general statutory construction, the fact that A. R. S. § 20-1109 was adopted subsequent to A. R. S. § 28-1170, on which appellees rely, makes it clear that the legislature intended that fraud would be available as a defense despite the provisions of the Financial Responsibility Act. Otherwise, they would have created an exception to A. R. S. § 20-1109.

In the absence of clear legislative intent to eliminate fraud as a defense such a construction is totally unjustified. In the case of *Virginia Farm Bureau Mutual Insurance Co. v. Saccio,* 133 S.E.2d 268 (Va. 1963), the insurer brought suit to establish that a policy was void from its inception since it had been issued in reliance upon the applicant's fraudulent misrepresentations. Virginia had a statute, Code § 38.1-336, quite similar to A. R. S. § 20-1109 authorizing an insurer to declare a contract void as a result of fraudulent misrepresentations. It was argued that the legislature in passing an assigned risk plan had created an exception to the "fraud statute". Refusing to find such an exception, the Court declared:

> "The right to rely on fraud as a defense should not be defeated in the absence of a clear showing that such was intended, either by legislative act or by the expressed intention or the course of conduct of the party entitled to so rely."

Indicative of the fact that a distinction should still be drawn in some instances between voluntary and nonvoluntary policies is the continuing California position, despite the strong statements of public policy quoted and relied upon by the Arizona court in *Jenkins* and *Sandoval,* that a California policy may be avoided for fraud in its procurement. See *Allstate Ins. Co. v. McCurry,* 36 Cal.Rptr. 731, District Court of Appeals, Div. 1, 1964; also *Civil Service Employees Ins. Co. v. Blake,* 53 Cal.Rptr. 701, District Court of Appeals, Div. 2, 1966. The latter case, decided in the fall of 1966, concludes as follows:

> "Appellants urge that the public policy favoring insurance coverage for all drivers is not achieved when a driver is left without coverage on the rescission of his policy for fraud. This is an argument for the legislature."

There Is an Express Decisive Policy Provision Before the Court in This Case Which Was Not Before the Court in Jenkins or Sandoval

The policy being construed in this case contains the following provision:

> "When this policy is certified as proof of financial responsibility for the future under the provisions of any motor vehicle responsibility law, such insurance as is afforded by this policy for bodily injury liability or property damage liability shall comply with the provisions of such law to the extent of the coverage and *limits of liability required by such law,* but in no event in excess of the limits of liability stated in this policy." (Emphasis added.)

There is no indication that there was any such provision in the policy being considered in *Sandoval v. Chenoweth,* 428 P.2d 98 (1967). Presumably if there were, it would have been the basis for a strong argument by counsel for the carrier and would have been discussed by the court.

The effect of such a provision has been very recently expressly considered by this Court in *Weekes v. Atlantic,* 370 F.2d 264. In that case the Court was considering whether or not an intoxication exclusion was valid. The Court there discussed in detail A. R. S. § 28-1170F1, on which appellees here rest their entire argument, in connection with a policy provision such as we have in this case. This Court said:

> "The Atlantic policy limits are $100,000/$300,000. The Financial Responsibility law provides, in pertinent part: A. R. S. 28-1170B:
>
> " 'The owner's policy of liability in-insurance must comply with the following requirements:
>
> . . .
>
> " '2. It shall insure the person named therein or any other person, as insured, using the motor vehi-

cle . . . with the express or implied permission of the named insured . . . subject to limits exclusive of interest and costs, with respect to each motor vehicle as follows:

"'(a) Ten thousand dollars because of bodily injury to or death of one person in any one accident.

"'(b) Subject to the limit for one person, twenty thousand dollars because of bodily injury to or death of two or more persons in any one accident.'

. . .

"A. R. S. 28-1170F:

. . .

"'1. The liability of the insurance carrier with respect to the insurance required by this chapter shall become absolute when injury or damage covered by the motor vehicle liability policy occurs . . . [A]nd no violation of the policy shall defeat or void the policy.'

It is section 1170F which nullifies the 'intoxicants' exclusion.

"The law also provides:

A. R. S. 28-1170G:

"'A policy which grants the coverage required for a motor vehicle liability policy may also grant lawful coverage in excess of or in addition to the coverage specified for a motor vehicle liability policy and the excess or additional coverage shall not be subject to the provisions of this chapter. With respect to a policy which grants the excess or additional coverage the term "motor vehicle liability policy" shall apply only to that part of the coverage which is required by this section.'

"The appealing parties find some conflict between the provisions of sections 1170B and 1170G and the provisions of section 1170F. We think that there is no conflict, and that section 1170F nullifies the exclusion only to the extent of the limits specified in section 28-1170B.

To us, section 28-1170G shows that this was the intent of the Arizona legislature. And there is nothing to the contrary in Atlantic's policy. It provides, with reference to State Financial Responsibility laws, as follows:

> "'When this policy is certified as proof of Financial Responsibility for the future under the provisions of the Motor Vehicle Financial Responsibility law of any state or province, such insurance as is afforded by this policy for bodily injury liability or for property damage liability shall comply with the provisions of such law which shall be applicable with respect to any such liability arising out of the ownership, maintenance or use of the automobile during the policy period, to the extent of the coverage and limits of liability required by such law, but in no event in excess of the limits of liability stated in this policy.'

To us, this shows an intent, first, to afford the coverage required by the law, and second, to limit the amount of liability to that required by the law. The policy is thus wholly consistent with the law."

It should be noted that this language of this Court is consistent with the language of the California Court in the *Globe* case on which Sandoval is largely based.

The Matter of the Policy Defense Is Different

In deciding that an owner's policy of liability insurance is applicable no matter who is driving the vehicle (*Jenkins*), and that no act of the insured subsequent to the accident shall operate to defeat an injured party's opportunity to receive compensation (*Sandoval*), the Arizona Supreme Court was dealing with two problems entirely different in origin and in nature from the problem we have here: fraud in the procurement of the policy itself. It could be argued that *Jenkins* and *Sandoval* impose no substantial additional

burdens upon an insurer, since many states require an omnibus clause in all policies, and the insurer in *Sandoval* at least had notice of a claim against him. (Presumably, in *Sandoval,* had the insurer not been given any opportunity to set aside the default judgment, there would have been a denial of due process of law.) However, an insurer is substantially prejudiced, and given overwhelming new unbargained for and unexpected burdens when *all* of its policies are rendered absolute upon the occurrence of an accident. Such a construction would encourage fraud and deceit and would create a legal relationship so unfair and unreasonable as to be unconscionable.

Further, in this case the insurer is a party who has been intentionally wronged, which was not true in *Jenkins* or *Sandoval.*

The Policy Considerations at Play Are Different in This Case Than They Were in Jenkins or Sandoval

Another reason why we believe fraud is still available as a policy defense is because to accept the contrary argument could defeat the goals of the court as expressed in cases such as *Jenkins* and *Sandoval.* If fraud in the procurement of a policy is no longer available as a defense, presumably insurance companies would not insure parties until they had an opportunity to fully investigate them, which would probably mean that a number of people would be driving around during this interval with no coverage at all, rather than with the coverage they presently have upon execution of the application.

CONCLUSION

The District Court erred. It ruled as it did because of its interpretation of one case, *Sandoval v. Chenoweth.* The Court failed to take into account the basis for the *Sandoval*

decision and the substantial and decisive distinctions between the facts of that case and the facts of this case. The error is clear and the judgment below produced a clearly inequitable result. It should be reversed.

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Attorneys for the Appellant

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JOHN J. O'CONNOR III

STATE OF ARIZONA
COUNTY OF MARICOPA—ss.

John J. O'Connor III, being first duly sworn, on oath deposes and says that on the 9 day of February, 1968, he mailed to James H. Green, Jr., Attorney for the Appellees, 32 Luhrs Arcade, Phoenix, Arizona, 85003, three copies of this Brief for Appellant Farmers Insurance Exchange.

JOHN J. O'CONNOR III

Subscribed and sworn to before me this 9 day of February, 1968.

Karen M. Bremer Bauer
Notary Public

My Commission Expires:

My Commission Expires Oct. 19, 1968